

1.B. Abusive Tax Shelter History

The Legislative History of Abusive Tax Shelters

There have been extensive efforts in the attempt to curb Abusive Tax Shelters. Some of the historical highlights of these efforts follow.

- In the 1950's through the early 1980's the courts dealt with the tax shelters, disallowing tax benefits and imposing penalties, but it was not completely effective - so a legislative solution was sought.
- Congress' first substantive response was the Tax Reform Act of 1976, which enacted the "at-risk" rules limiting individuals from claiming losses for certain investments for which they had limited economic risk.
- In the Revenue Act of 1978, the at-risk rules were extended to a broader array of activities
- The Economic Recovery Tax Act of 1981 extended the at-risk rules still further.
- Congress then passed the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). This Act primarily contained procedural and penalty type changes.
- Congress then passed the Deficit Reduction Act of 1984 which contained numerous provisions aimed at tax shelters.

–For the first time, it became necessary to register tax shelters with the IRS, which was designed to help the IRS locate and evaluate tax shelters, IRC §6111.

–Organizers and sellers of "potentially abusive tax shelters" also were required to maintain a list of investors in registered shelters, IRC § 6112

–Certain penalties were significantly strengthened, IRC §§ 6700, 6701, & 7408

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1.B. Abusive Tax Shelter History, Continued

**The Legislative
History of
Abusive Tax
Shelters**

Continued

Congress passed the Tax Reform Act of 1986.

–This law enacted the “passive loss” rules which prevent an individual (but not a corporation) from claiming a loss from an activity, unless the individual materially participated in the activity.

–The Tax Reform Act of 1986 greatly reduced tax shelters for individuals.

–Because of these changes in the law, the focus of tax shelter activity moved to the corporate arena, where the passive loss rules do not apply and the tax law is more complex.

•Uruguay Round Agreements Act of 1994

–The ability of corporations to avoid the substantial understatement penalty for tax shelter items based on substantial authority and reasonable belief under IRC § 6662 was eliminated. Instead, corporations could avoid the penalty for tax shelter items only if they established reasonable cause under IRC § 6664(c).

1.B. Abusive Tax Shelter History, Continued

Abusive Tax Shelter History in Recent Years

In 1997, Congress added IRC § 6111 to require the registration of confidential corporate tax shelters (IRC § 6111(d)).

In 1998, as part of the IRS Restructuring and Reform Act, Congress instructed the Joint Committee on Taxation (JCT) and Treasury to conduct studies of the present-law and interest provisions and make legislative or administrative recommendations. These studies, designed in part to propose methods to curb the activities of corporate tax shelters, included the JCT Penalty Study, JCX-84-99 (July, 1999), and the Treasury Department's studies included in the Treasury White Paper (July, 1999) and Penalty Study (October, 1999).

In addition, the IRS

- (1) took administrative action designed to “shut down” certain identified tax shelters in which both corporations and individual taxpayers had invested; and
- (2) established the Office of Tax Shelter Analysis (OTSA) to serve as the focal point in the war on tax shelters.

The Treasury Department also proposed regulatory changes to the standards of practice for tax practitioners that would impact the way they are able to advise tax shelter investors, (i.e. Circular 230).

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1.B. Abusive Tax Shelter History, Continued

Curbing Abusive Tax Shelters

The following were set in place in an effort to curb abusive tax shelters:

- Regulations requiring that corporate taxpayers disclose on their tax returns investments in certain “reportable transactions” under IRC § 6011-4;
- Notice 2000-15, 2000-12 listing ten known abusive transactions, identified as “listed transactions”.
- Rev. Rul. 2000-12, 2000-11 involving the IRS’ attempt to shut down debt straddle tax shelters; and
- Announcement 2000-12, which summarizes the new rules and announces the creation of OTSA to serve as the IRS’ focal point to gather and analyze information regarding the new registration, list maintenance and return reporting requirements for tax shelters, and to coordinate responses to the abusive tax shelter problem.

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1.B. Abusive Tax Shelter History, Continued

Chronology of Events in 2000

The following sections reflect the major activities in the corporate tax shelter area in 2000.

February 28, 2000

On this date, the IRS issued the following items of guidance in its efforts to regulate and curtail the use of abusive tax shelters:

- Temporary and proposed regulations requiring the registration of confidential corporate tax shelters under IRC § 6111 (d)
- Temporary and proposed regulations requiring the maintenance of lists of investors in investments in certain corporate tax shelters under IRC § 6112
- Temporary and proposed regulations requiring corporate taxpayers to disclose on their tax returns investments in certain “reportable transactions” under Treas. Reg. 1.6011-4T
- Notices 2000-15 which identifies ten different “listed transactions” for purposes of compliance with the above three sets of temporary and proposed regulations;
- Rev. Rul. 2000-12 involving the IRS’ attempt to shut down debt straddle tax shelters; and
- Announcement 2000-12, which provides a general description of the new rules and announces the creation of OTSA to serve as the focal point of the IRS’ efforts to combat abusive tax shelters.

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1.B. Abusive Tax Shelter History, Continued

May 11, 2000 The IRS issued a Notice of Proposed Rulemaking (NPRM) to amend Circular 230, which governs the standards of practice for all practitioners before the IRS (attorneys, accountants, and enrolled agents). One of the purposes behind this NPRM was to warn the law and accounting firms that put together tax shelter transactions, as well as the practitioners and chief financial officers who used them, that their professional reputations and fortunes might suffer if the rules were not followed. In the NPRM, which the IRS also published in the form of Announcement 2000-51, the IRS requested public comments on its intent to revise these standards, with particular focus on the proposals to amend the standards under which practitioners operated when preparing and issuing opinions on tax shelters.

May 24, 2000 The Senate Finance Committee released a bipartisan preliminary Staff Discussion Draft of legislative proposals designed to alter the cost-benefit analysis of corporations and other participants entering into corporate tax shelter transactions. This Discussion Draft also included proposals to amend the Circular 230 requirements concerning the provision of opinions on tax shelters. The proposals were incorporated into the Taxpayer Bill of Rights 2000 legislation, which was not enacted in 2000. However, since the general feeling in Congress is that there needs to be some statutory overhaul to accompany the executive and judicial branches' efforts in this area, these proposals still remain a first-order-of-business for Congress.

May 30, 2000 The IRS announced that the Office of Tax Shelter Analysis was up and running and ready to respond to questions, as well as to accept tips, "relating to potentially improper tax shelter activity by corporate and noncorporate taxpayers."

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1.B. Abusive Tax Shelter History, Continued

June 20, 2000 A hearing was held to air comments on the proposed and temporary regulations. Comments were received from a number of organizations, most notably the American Institute of Certified Public Accountants, the Tax Executives Institute, and the Chicago Bar Association, all of whom provided written comments and testified at the hearing. The common thread in all the comments was that the regulations had been drafted in a manner that was overly broad, and that they might lead to the targeting of individuals, businesses, and transactions that were merely involved in legitimate, everyday business transactions, and in permitted tax planning.

August , 2000 Notice 2000-44 was released which identified the “Son of Boss” transaction as a listed transaction.

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**October-
November 2000**

Another series of IRS rulings and Treasury warnings began. Included in this series of activities was:

- Notice 2000-60 was released attacking a series of transfers between a parent corporation and its subsidiary designed to create artificial losses for the parent by utilizing employee stock compensation arrangements. The IRS recharacterized the basis transfer from the subsidiary to the parent corporation as a dividend to the parent.
 - Notice 2000-61 (along with a Treasury Department Press Release) disallowing an arrangement in which corporations and individuals had been marketed trusts in Guam on the premise that the trusts would be treated as individuals for tax purposes, and that income taxes would only be required to be paid in Guam (and not in the United States).
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**LMSB
the IRS
Administrative
Action 2001**

On September 6, 2001 the Large & Midsize Business Division (LMSB) of the IRS established a Tax Shelter Committee to serve as a sub-committee of its Compliance Strategy Council. The Tax Shelter Committee provides leadership in combating abusive tax shelters and is responsible for making key decisions in implementing LMSB's strategic initiative #5 dealing with tax shelters.

On December 10, 2001 LMSB established an IRC § 6700 Committee to serve as a sub-committee of the Tax Shelter Committee. This committee is charged with responsibility to approve all LMSB tax shelter promoter activities, including promoter contacts, investigations and penalties.

I.B. Abusive Tax Shelter History, continued**June 14, 2002**

Temporary and Proposed regs. were issued modifying the rules on reporting and registering tax shelters under IRC §§6011, 6111, and 6112. The new regs. extend the disclosure requirements for listed transactions under §1.6011-4T to individuals, trusts, S corporations, and partnerships. The regs. also clarified the definition of “substantially similar” as taxpayers were construing the term in very narrow terms to avoid disclosure. The new regs. eliminated the “projected tax effect test”, thereby requiring all corporations, individuals, trusts, partnerships and S corporations to disclose if they participate in a listed transaction.

**Recent
Information**

A good way to keep up with recent tax shelter information is to research Tax Notes Today articles for recent “abusive tax shelter” articles. It is also important to check the “What’s New” section of the OTSA web site.